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CERTIFICATE OF SERVICE

RE: Case No. 2002-00475
American Electric Power

I, Thomas M. Dorman, Executive Director of the Public Service Commission, hereby certify that the enclosed attested copy of the Commission's Order in the above case was served upon the addressee by U.S. Mail on July 17, 2003.

Executive Director

TD/sh
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This is the Service List for Case 2002-00475

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF KENTUCKY POWER COMPANY D/B/A AMERICAN ELECTRIC POWER FOR APPROVAL, TO THE EXTENT NECESSARY, TO TRANSFER FUNCTIONAL CONTROL OF TRANSMISSION FACILITIES LOCATED IN KENTUCKY TO PJM INTERCONNECTION, L.L.C. PURSUANT TO KRS 278.218	))))))))	CASE NO. 2002-00475

O R D E R

On December 19, 2002, Kentucky Power Company d/b/a American Electric Power ("Kentucky Power") filed an application, pursuant to KRS 278.218, requesting approval to transfer control of certain transmission facilities to PJM Interconnection, L.L.C. ("PJM"). Intervenors are the Attorney General of the Commonwealth of Kentucky ("AG"), Kentucky Industrial Utility Customers, Inc. ("KIUC"), and PJM. The Commission established a procedural schedule which provided for written discovery, two informal conferences, and a formal hearing on March 25, 2003. Responses to post-hearing data requests have been received and all parties have filed post-hearing briefs. The case now stands submitted for decision.

STANDARD OF REVIEW

Kentucky Power's proposed transaction falls within the purview of KRS 278.218(2). Enacted by the General Assembly in 2002, the statute mandates Commission approval prior to the transfer of ownership or control of a utility's assets.

The statute provides, in part, "The Commission shall grant its approval if the transaction is for a proper purpose and is consistent with the public interest." There is no statutory definition of "public interest." In recent cases involving the transfer of ownership of Kentucky-American Water Company, the Commission noted that "[t]he parties agree that a proposed transfer of control is in the public interest when the proposed transfer produces some benefits for the public and does not adversely affect the utility or the quality of its service."[1] The Commission then expanded on its interpretation of the "public interest" as follows:

> [A]ny party seeking approval of a transfer of control must show that the proposed transfer will not adversely affect the existing level of utility service or rates or that any potentially adverse effects can be avoided through the Commission's imposition of reasonable conditions on the acquiring party. The acquiring party should demonstrate that the proposed transfer is likely to benefit the public through improved service quality, enhanced service reliability, the availability of additional services, lower rates or a reduction in utility expenses to provide present services. Such benefits, however, need not be immediate or readily quantifiable.[2]

While the transaction proposed here involves the transfer of functional control of utility assets, rather than a transfer of ownership of the assets, the same criteria apply in determining whether the transaction satisfies the "public interest" standard.

SUMMARY OF DECISION

As the applicant in this case, Kentucky Power bears the burden of proof. *Energy Regulatory Commission v. Kentucky Power Co.*, Ky.App., 605 S.W.2d 46 (1980). The

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[1] Case No. 2002-00018, Application for Approval of the Transfer of Control of Kentucky-American Water Company to RWE Aktiengesellschaft and Thames Water Aqua Holdings GMBH, Order dated May 30, 2002.

[2] *Id.* at 7-8.

fact that the only testimony presented was from the applicant in support of the proposed transfer does not require the Commission to approve the transfer. The Commission may analyze and weigh all the evidence, including that adduced during discovery and at the hearing, and find it insufficient to meet the applicant's burden. Further, we herein take administrative notice of Federal Energy Regulatory Commission ("FERC") filings and decisions that have bearing on this case. We also have, as we must, considered relevant portions of KRS Chapter 278, including KRS 278.214, which is in clear conflict with Kentucky Power's proposal.

The evidence of record fails to show that the transfer is both for a proper purpose and consistent with the public interest. Therefore, for the reasons discussed more fully below, we deny Kentucky Power's request for approval to transfer control of its transmission assets to PJM.

BACKGROUND

Kentucky Power owns facilities used to generate, transmit, and distribute electricity to approximately 170,000 customers in eastern Kentucky. Kentucky Power is a wholly owned subsidiary of the American Electric Power Company ("AEP"), a multi-state registered public utility holding company. For many years AEP owned five electric utility companies in the Midwest that collectively provided service to parts of the following seven states: Indiana, Kentucky, Michigan, Ohio, Tennessee, Virginia, and West Virginia. AEP's operations in the Midwest are now collectively referred to as "AEP-East."

In 1998, AEP announced a merger with Central and South West Corporation ("CSW"). CSW owned four utilities that operated in parts of Arkansas, Louisiana, Oklahoma, and Texas. Since the merger with AEP, the territory formerly served by CSW is now commonly known as "AEP-West."

As part of FERC's approval process for the AEP/CSW merger, AEP negotiated a settlement with certain Ohio intervenors. The settlement included an obligation that AEP-East join an RTO, an obligation adopted by FERC and expressed as a condition of the merger.[3] The Securities and Exchange Commission ("SEC") also approved the AEP/CSW merger, but that approval was subsequently overturned on appeal.[4] The SEC has not yet taken up the case on remand.

<u>RTO Membership</u>

AEP, along with a number of Midwest electric utilities, has spent considerable time and effort to organize an independent entity to operate the utilities' respective transmission facilities. Those efforts culminated in the formation of the Midwest Independent System Operator, Inc. ("MISO"), but AEP ultimately chose not to join. Instead, it coordinated its efforts with a small number of midwest utilities to form a similar entity to be known as the Alliance RTO. After years of effort and significant expense,[5] the Alliance RTO was rejected by FERC.[6] AEP then negotiated with MISO

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[3] *American Electric Power Co. & Cent. & S.W. Corp.*, 90 F.E.R.C. ¶ 61,242 (Mar. 15, 2000), *aff'd sub nom, Wabash Valley Power Ass'n v. FERC*, 268 F.3d 1105 (D.C. Cir. 2001).

[4] *National Rural Electric Corp. Association v. Securities and Exchange Commission*, 276 F.3d 609 (D.C. Cir. 2002).

[5] AEP alone incurred $11 million in expenses related to the Alliance RTO. <u>See</u> American Electric Power Service Corporation, FERC Docket No. AC03-20-000, Order issued July 2, 2002 at para. 6.

[6] Alliance Companies, et al., 97 F.E.R.C. ¶ 61,327 (Dec. 20, 2001).

and PJM, and ultimately decided that AEP-East should join PJM. Due to the geographic location of AEP-East within PJM, AEP-East will operate within a sub-region known as PJM-West.

In July 2002, FERC conditionally accepted AEP's decision to join PJM, subject to further consideration of certain rate issues. In April 2003, FERC issued a subsequent order approving the membership of AEP-East in PJM.[7]

PJM

PJM started as an association of transmission owners in 1927. It was approved by FERC as an independent system operator ("ISO") in 1998 and as an RTO in December 2002. It controls transmission facilities in all or parts of Pennsylvania, Delaware, Maryland, Virginia, New Jersey, and the District of Columbia. PJM also operates a recently established sub-region, known as PJM-West, in Maryland, Ohio, Pennsylvania, Virginia, and West Virginia. PJM's role is to ensure the reliable and safe operation of bulk power facilities within its region and to operate a competitive wholesale electricity market therein.

[7] *American Electric Power Service Corp., et al.*, 103 F.E.R.C. ¶ 61,008 (April 1, 2003).

FERC RTO Initiatives

To facilitate the creation of a national wholesale market for electricity, FERC issued Orders 888[8] and 889[9] in 1996 and Order 2000[10] in 1999. Orders 888 and 889 required FERC-jurisdictional utilities to provide open access to their transmission facilities on a non-discriminatory basis, as well as to "unbundle" their wholesale power rates into the functional components of generation and transmission.

Order 2000 requested transmission-owning utilities to participate in RTOs on a voluntary basis. This request extended to transmission-owning utilities primarily serving bundled retail load in states that had not restructured their electric industries. RTOs were intended to be independent bodies with functional control over utility transmission systems. FERC took the position that an independent entity was needed to improve

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[8] See *Promoting Wholesale Competition Through Open Access Non-Discriminatory Transmission Services by Public Utilities*, Order No. 888, 61 Fed. Reg. 21,540 (May 10, 1996), *clarified*, 76 F.E.R.C. ¶ 61,009, 1996 WL 363765 (July 2, 1996) and 61 Fed. Reg. 51,696 (Oct. 3, 1996), *on reh'g*, Order No. 888-A, 62 Fed. Reg. 12,274 (Mar. 14, 1997), *clarified*, 79 F.E.R.C. ¶ 61,182, 1997 WL 257595 (May 16, 1997), *on reh'g*, Order No. 888-B, 62 Fed. Reg. 64,688 (Dec. 9, 1997), *on reh'g*, Order No. 888-C, 82 F.E.R.C. ¶ 61,046, 1998 WL 18148 (Jan. 20, 1998), *aff'd, Transmission Access Study Policy Group v. F.E.R.C.*, 225 F.3d 667 (D.C. Cir. 2000), *aff'd, New York v. F.E.R.C.*, 535 U.S. 1 (2002).

[9] See *Open Access Same-Time Information System and Standards of Conduct*, Order No. 889, 61 Fed. Reg. 21,737 (May 10,1996), *on reh'g*, Order No. 889-A, 62 Fed. Reg. 12,484 (Mar. 14, 1997), *on reh'g*, Order No. 889-B, 62 Fed. Reg. 64,715 (Dec. 9, 1997), *aff'd, Transmission Access Study Policy Group v. F.E.R.C.*, 225 F.3d 667 (D.C. Cir. 2000), *aff'd, New York v. F.E.R.C.*, 535 U.S. 1 (2002).

[10] See *Regional Transmission Organizations*, Order No. 2000, 65 Fed. Reg. 810 (Jan. 6, 2000), *on reh'g*, Order No. 2000-A, 65 Fed. Reg. 12,088 (Mar. 8, 2000).

efficiencies on the transmission grid and reduce opportunities for transmission owners to discriminate against power transfers by non-affiliates.[11]

In early 2002, FERC issued several documents regarding the development of RTOs. This Commission filed comments and identified concerns regarding the impact of RTO initiatives on Kentucky and its electric customers. These FERC documents were the precursors to FERC's Standard Market Design ("SMD") Notice of Proposed Rulemaking issued in July 2002.[12] This Commission again filed comments and objections explaining that the proposed SMD rules would harm Kentucky and its electric customers. The major concerns we identified in that docket include the following:

> 1) FERC's preemption of state jurisdiction would hinder each state's ability to protect its own electricity customers;
>
> 2) The proposed destruction of state regulatory authority in favor of "advisory" regional entities that have neither legal authority nor accountability to citizens is wholly inappropriate;
>
> 3) RTOs, rather than state regulatory commissions, would decide who pays for transmission upgrades and expansions necessary to facilitate wholesale bulk power transfers;
>
> 4) RTO expenditures are increasing constantly, but are not being reviewed;
>
> 5) FERC has concluded that exclusive territories for retail suppliers, which Kentucky law requires, is somehow "discriminatory";

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[11] *Id.*

[12] Remedying Undue Discrimination Through Open Access Transmission Service and Standard Electricity Market Design (F.E.R.C. Docket No. RM01-12-000).

> 6) The proposed SMD rules conflict with Kentucky law requiring Kentucky retail ratepayer priority if transmission curtailment is necessary, see KRS 278.214; and
>
> 7) There is no certainty that rights of retail ratepayers to the use of the transmission facilities for which they have paid will not be assigned elsewhere.

The concerns expressed by the Commission in objection to FERC's proposed SMD and RTO initiatives were based not just on the potential for future harm, through intentional or unintended consequences, but also on actual present harm. For example, one of the conditions to which the founding transmission owners of MISO agreed was that bundled retail load would not be charged the MISO administrative fee for 6 years in recognition that bundled retail load received very little benefit from MISO. However, this basic condition, to which all MISO members had agreed in order to encourage membership by transmission owners in bundled states, was rejected by FERC in Order 453.[13] By retroactively applying new transmission policy to the filed MISO agreement, FERC mandated that bundled retail load pay the MISO administrative fee.[14] As a result of this FERC decision, two Kentucky utilities that are members of MISO must now pay over $5 million annually, with additional costs deferred for future recovery.

CASE HISTORY

Kentucky Power originally requested an expedited review of its application in this proceeding based on target dates for AEP-East to transfer functional control of its facilities to PJM in the spring and early summer of 2003. Due to a number of legal and

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[13] *Midwest Independent Transmission System Operator, Inc.* 97 F.E.R.C. ¶ 61,033 (2001).

[14] *Midwest Independent Transmission System Operator, Inc.* 102 F.E.R.C. ¶ 61,192 at para. 6 (2003).

regulatory issues that have arisen in various jurisdictions and proceedings, including FERC, Ohio, and Virginia, PJM has since indicated that transfer of functional control of AEP's facilities cannot take place before October 2003.[15]

AEP is presently seeking all necessary state approvals to join PJM. The Indiana commission has heard, but has not yet ruled upon, the matter.[16] Ohio has held its case in abeyance, citing many uncertainties at this time,[17] while Michigan and West Virginia do not presently have cases pending. In Virginia, legislation has been passed that prevents any incumbent utility from joining an RTO prior to July 2004.[18] As part of the application process in Virginia, the utility must show the costs and benefits to native load customers.

KENTUCKY POWER AND PJM ARGUMENTS

Both Kentucky Power and PJM offered numerous arguments in support of Kentucky Power's request to transfer functional control of its transmission facilities to PJM. Following is a summary of those arguments.

Kentucky Power

Kentucky Power states that FERC's approval of the AEP-CSW merger was conditioned on AEP joining an RTO; therefore, while AEP has discretion as to which RTO to join, it has no discretion in determining whether to become part of an RTO.

[15] In its brief, AEP stated that it still seeks an expedited decision in this matter in order to have all approvals in place prior to the transfer of control of its facilities to PJM.

[16] March 25, 2003 hearing, Transcript of Evidence ("T.E.") at 65-66.

[17] Kentucky Power's response to March 25, 2003 hearing data request, Item 1.

[18] See HB 2453, *codified at* Va. Code Ann. § 56 (Michie 2003).

Kentucky Power cites PJM's experience in operating an electric transmission grid in the eastern United States for decades as one reason for AEP's choice to join PJM. It also cites PJM's authorization by FERC to serve as the independent system operator for all or parts of New Jersey, Delaware, Maryland, Pennsylvania, Virginia, and the District of Columbia, as well as PJM's experience in integrating new members into its "footprint" in an expedited and cost-effective manner.

Kentucky Power states that its participation in PJM, as part of the AEP-East system, will improve the reliability and competitiveness of interstate wholesale energy markets and expand the generation sources economically available to its customers. It further states that participation in PJM will result in the congestion problem in the West Virginia-Virginia portion of the AEP-East system being addressed in a comprehensive manner by PJM since the systems most affected (AEP-East, Allegheny Power and Virginia Power) will be in PJM.[19] In addition, Kentucky Power cites to PJM already operating state-of-the-art day-ahead and real-time energy markets.

Kentucky Power states that the RTO choice for AEP-East must be made in light of the issue of retail choice, since three of the seven states in which the AEP-East system operates have adopted retail choice. Therefore, it cites as advantages PJM's ancillary services and energy imbalance markets, as well as PJM's experience in operating state-of-the-art day-ahead and real-time energy markets.

[19] This congestion area is referred to as the Kanawha-Matt Funk congestion point by AEP. AEP has proposed to relieve the congestion by constructing a new transmission line, but all necessary regulatory approvals have not yet been obtained.

PJM

PJM asserts that the proposed transfer will enhance our jurisdiction by providing new regulatory tools and resources to assist us in carrying out our duties under KRS Chapter 278. It states that establishment of a transparent market price will provide the Commission with market data not currently available with which it can judge the reasonableness of Kentucky Power's purchasing practices. PJM also states that it will serve as an independent market monitor for the AEP-East region and that the Commission can call upon PJM for various analysis and studies.

PJM argues that, after the proposed transfer, Kentucky Power's customers will receive the same or better service at the same rates. PJM cites a study it performed for the Virginia Corporation Commission which shows that total savings, with all the AEP-East utilities as members of PJM, will be between $61 million and $80 million annually.[20] It claims that, under its emergency rules, native load customers, along with wholesale firm power customers, will receive the highest priority of service, consistent with the provisions of KRS 278.214.[21] PJM claims that its allocation procedures for transmission upgrades comport with KRS 278.212(2), which states that the costs of upgrades required by a merchant generating facility will be borne by that facility and not by Kentucky retail ratepayers.

PJM points out that its spot energy markets are voluntary and that Kentucky Power may participate therein, elect to self-supply, or enter into bilateral purchase

[20] Prepared Testimony of Andrew L. Ott on Behalf of PJM Interconnection, L.L.C. at 6-8 and Attachment A.

[21] KRS 278.214, of course, gives Kentucky's retail ratepayers priority over other "firm" power customers.

power contracts to meet its demand. However, in any case, it argues that the transparency of its markets allows market participants to make better economic choices. PJM states that its use of locational marginal pricing ("LMP") is an economical way to manage transmission congestion and an improvement over existing transmission loading relief curtailment procedures. It cites its experience in reliably controlling electric systems and its existing regional planning process as benefits available to Kentucky Power as a member of PJM. Furthermore, PJM points to its market monitoring service and its rules of governance as factors that will allow the Commission to more effectively regulate Kentucky Power. PJM argues that Kentucky Power's membership in PJM will result in PJM and MISO being the two RTOs providing services in Kentucky and that this will assist the Commonwealth by having all of its FERC jurisdictional utilities operating pursuant to a compatible set of market rules.

INTERVENOR POSITIONS

Neither the AG nor KIUC submitted testimony in this matter. Both intervenors, however, filed post-hearing briefs stating their respective opposition to Kentucky Power's request to transfer functional control of its transmission facilities to PJM. The AG cites the lack of a Kentucky-specific analysis and also cites that organizations further removed from the local level, i.e., FERC and PJM, would be in charge of policy and decision making regarding Kentucky Power's transmission system. KIUC cites the same concerns and argues that FERC does not have the authority to force Kentucky Power to transfer control of its transmission assets to PJM. Both the AG and KIUC state that Kentucky Power has not met its burden of showing that the proposed transfer is for a proper purpose and is consistent with the public interest.

COMMISSION ANALYSIS

RTO Membership

The Commission is not required to approve Kentucky Power's membership in PJM or any other RTO. While Kentucky Power argues that RTO membership was a condition imposed by FERC in approving the AEP-CSW merger, the record shows that AEP voluntarily agreed to such membership. It was this voluntary agreement that FERC then elevated to a merger condition. In any event, the Court of Appeals for the District of Columbia Circuit definitively ruled in *Atlantic City Electric Co., et al. v. FERC*, 295 F.3d 1 (D.C.Cir. 2002) that FERC's jurisdiction under Section 203 of the Federal Power Act to approve the disposition of facilities does not encompass a utility's decision to transfer operational control of transmission facilities to an ISO, or RTO. The court held:

> Nor does FERC have jurisdiction under Section 203 of the [Federal Power] Act to require the utility petitioners to modify the ISO agreement to allow withdrawal only upon approval by the Commission. A utility does not 'sell, lease, or otherwise dispose' of facilities when it agrees to the changes in operational control necessary to withdraw from (<u>or initially join</u>) an ISO.

Atlantic City at 15 (emphasis added). The court also ruled that Section 202 of the Federal Power Act "does not provide FERC with any substantive powers to compel any particular interconnection or technique of coordination." *Atlantic City* at 13. In brief, FERC has no jurisdiction to require a utility to join an ISO or RTO.[22]

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[22] The United States Court of Appeals for the District of Columbia Circuit entered an order enforcing the mandate in this case on May 20, 2003, chiding FERC for failure to comply with its previous ruling.

We do note that, to date, FERC has not attempted to preempt any state law governing RTO membership. Ohio's legislation requiring RTO membership applies only to entities that own or control transmission facilities in Ohio.[23] Similarly, KRS 278.218 applies only to Kentucky jurisdictional utilities, including Kentucky Power. While FERC has approved AEP-East's membership in PJM, AEP has advised FERC that, "AEP cannot be expected, in defiance of state laws and concerns, unilaterally to take actions that states have prohibited or for which states have declined to provide requisite approvals."[24]

Cost/Benefit Study

Kentucky Power's brief noted that the lack of a cost/benefit analysis of joining PJM was one of the issues raised in this case. Kentucky Power attempted to address the issue by stating that a cost/benefit study is appropriate when deciding among alternative courses of action but here there is no alternative to joining an RTO.[25] The Commission finds no merit in this argument. KRS 278.218 prohibits the Commission from approving a transfer of assets absent a showing of "proper purpose and consistent with the public interest." Having readily quantified cost increases resulting from PJM membership, Kentucky Power is obligated to quantify the benefits of membership. However, neither Kentucky Power nor AEP-East performed any type of analysis to support the decision to join PJM.

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[23] Section 4928.12(A), Ohio Revised Code.

[24] AEP Report on Compliance with Transmission-Related Merger Conditions at 16, F.E.R.C. Docket Nos. EC98-40-000, ER98-2786-000 (Feb. 28, 2003).

[25] Kentucky Power Brief at 16.

Kentucky Power indicates that only administrative costs (estimated at $45 million annually for AEP-East, $3 million of which would be Kentucky Power's responsibility), are relevant in the decision to join PJM since congestion management costs and generation adequacy costs are not expected to be significant. The basis for Kentucky Power's expectation is historical information, which fails to recognize or even consider the transmission flows and generation re-dispatch that may occur once LMP is implemented by AEP-East and the other new members in the PJM-West region. In addition, generation adequacy costs are still being debated within PJM and have not yet been established. This means that Kentucky Power could be required to pay twice for adequate generating reserves: once through its owned and purchased generation, and again through the PJM tariff charges. Absent any analysis by Kentucky Power or AEP to quantify the benefits of PJM membership, the record contains only vague, unmeasurable claims that the reliability and competitiveness of wholesale markets will improve.[26] These vague claims stand in stark contrast to Kentucky Power's admission that there have been no specific instances of unreliable transmission service to native load customers over the past 3 years.[27]

PJM submitted a market analysis it had performed for the Virginia Corporation Commission. The analysis studied the entire AEP-East system but could not be broken down to reflect any of the five individual utilities in AEP-East. Based on projections for power prices and sales, the PJM analysis concluded that the AEP-East system could

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[26] Baker Direct Testimony at 10.

[27] Kentucky Power's response to Commission Staff's First Data Request, Item 12.

receive annual benefits of $61 million to $80 million from membership in PJM due to a combination of cost savings from buying more power in PJM at a lower cost than is now incurred to generate such power and increased revenues from selling more power in PJM at higher prices than now received for such power.

However, when questioned on the underlying assumptions in its study, PJM admitted it had no knowledge of how costs and revenues were accounted for by AEP-East and acknowledged that it was possible for Kentucky Power to incur increased costs due to membership in PJM without receiving a pro rata share of increased revenues.[28] Further, Kentucky Power admitted that, because its generation had some of the lowest costs of both AEP-East and PJM, any ability to purchase lower cost power would likely be for only a few hours per year during off-peak periods.[29] Kentucky Power filed schedules showing that in the last 3 years it had purchased and sold significant quantities of power. However, when asked to show how the cost to purchase power, or the revenue from selling power, would have been different if it had been a member of PJM, it was unable to do so.[30] PJM also was unable to provide such an analysis.[31] Thus, the record demonstrates that Kentucky Power will receive minimal, if any, benefits from joining PJM, but will be required to pay at least $3 million annually for membership.

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[28] T.E. at 178-179.

[29] T.E. at 57-58.

[30] Kentucky Power's response to Commission Staff's First Data Request, Items 10 and 11.

[31] T.E. at 149-151.

Neither Kentucky Power nor PJM made any effort to perform a Kentucky Power-specific analysis, despite knowing that KRS 278.218 requires the Commission to find the asset transfer to be "consistent with the public interest." It is significant to note that, although PJM performed a system-wide analysis of AEP-East, Kentucky Power's witness declined to answer questions about that analysis. Although the witness had previously seen the analysis, he deferred all questions to PJM.[32]

CONCLUSIONS

Kentucky Power was unable to quantify any benefits to Kentucky customers from PJM membership. The record shows that Kentucky Power will incur $3 million per year in administrative costs as a result of AEP-East joining PJM.[33] This can be viewed as a minimum cost level that is likely to increase over time as FERC assigns additional functions and responsibilities to RTOs, or as PJM elects to take on additional functions and responsibilities. Moreover, FERC has conducted no review to determine the reasonableness of RTO costs incurred by AEP or PJM.

Additionally, a portion of the PJM administrative costs pays for its day-ahead and real-time markets, as well as the PJM congestion management system. Although these services may benefit PJM's multi-state wholesale market, they bring no discernible benefits to Kentucky Power's retail customers. Such benefits to the PJM's multi-state wholesale market will not be realized by Kentucky Power's retail customers since they

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[32] T.E. at 16-17.

[33] The record also shows that, "AEP does not anticipate significant additional workforce reductions in the immediate future as a result of transferring functional control of its transmission system to PJM." Responses of Kentucky Power d/b/a American Electric Power to Commission Staff's First Set of Data Request, Item 17, p. 2 of 2.

receive bundled service and Kentucky Power meets its load with generation that it owns or purchases under bilateral contracts, except for a few hours each year during peak periods.

One of the more emphasized benefits of membership in PJM is the use of LMP to manage transmission congestion, improve transmission loading relief curtailment procedures and encourage investment in needed new transmission and generation. However, the record herein shows that there were no specific instances of unreliable transmission service or congestion in Kentucky Power's service area impacting its native load customers over the past 3 years.[34] Furthermore, the Commission has previously found, in Administrative Case No. 387, that the existing transmission facilities in Kentucky were adequate to serve Kentucky's native load and much of the merchant generating capacity planned in Kentucky.[35] Therefore, any benefits of LMP would, at best, address a problem that is non-existent in Kentucky. The only significant congestion in AEP-East is in West Virginia, at the Kanawha-Matt Funk point, and its primary impact is on service in Virginia and on the ability of AEP-East to make off-system sales.

Simply creating a larger wholesale market that extends from the Midwest region to the mid-Atlantic region will not bring cheaper power to Kentucky. As Kentucky Power's base load generation is at or near the lowest cost of generation in both AEP-

[34] Kentucky Power's responses to Commission Staff's First Set of Data Request, Item 12.

[35] Administrative Case No. 387, A Review of the Adequacy of Kentucky's Generation Capacity and Transmission System, Order dated December 20, 2001, at 94-95.

East and PJM, being part of the PJM market will bring no quantifiable benefit to Kentucky Power.[36] Furthermore, under the AEP Interconnection Agreement, which governs the operation and pricing of generation within AEP-East, any excess power on Kentucky Power's system must first be sold at cost to its four affiliates in AEP-East. Since Kentucky Power's generation has some of the lowest costs in AEP-East, it is unlikely that more than a minimal amount of Kentucky Power's excess power will be available for sale in PJM's wholesale market.

The evidence in this case clearly shows that Kentucky Power's cost to be a member of PJM is known, specific, and quantifiable, but the benefits of that membership are general in nature and unquantified. While PJM has quantified benefits for AEP-East, those benefits have not been shown to flow to Kentucky Power. Thus, it appears that Kentucky customers would subsidize the cost of PJM membership for other AEP-East utilities. The record demonstrates that Kentucky Power will receive minimal, if any, benefits in return for its $3 million annual membership fee. In addition, Kentucky Power has stated that there will be no significant workforce reductions from PJM membership, despite the fact that AEP-East will no longer perform many of its current transmission functions.[37] Thus, PJM's labor costs will supplement, rather than supplant, those costs currently incurred by Kentucky Power.

In more general terms, we must also express herein our grave concern at the prospect of surrendering even a portion of our authority to protect Kentucky Power's

[36] Kentucky Power's updated response to Commission Staff's Supplemental Data Request, Item 10(a), filed March 12, 2003, attached hereto as Appendix A.

[37] See Footnote No. 33 above.

customers. Experience over the past few years has taught us that the transfer of control of a utility's transmission system is to be approached most cautiously. FERC policies now encourage entities outside Kentucky to exercise authority over resource adequacy, transmission rights, transmission planning, and cost allocation of transmission upgrades. Since these are all issues that have traditionally been subject to state jurisdiction, we must look very carefully at any petition of a Kentucky utility for authority to place its transmission system under an RTO that is not subject to the jurisdiction of this Commission. However, Kentucky Power's application is clearly flawed in itself due to its failure to quantify any benefits of PJM membership.

Further, PJM acknowledged at the hearing that in the future it could revise its rules to require all member generation to be sold into PJM.[38] In such an eventuality, Kentucky Power's customers would be required to pay the average rate for power sold in the PJM market. Since the cost of generation for the existing PJM members is significantly higher than the cost for Kentucky Power, the financial impact would be devastating and severely hamper future economic development efforts in eastern Kentucky.

Finally, we note that our approval of the proposed transfer would be tantamount to acquiescence in violation of the law we are required to enforce. KRS 278.214 requires that, when a Kentucky utility or generation and transmission cooperative experiences an event that necessitates curtailment or interruption of service, its customers within its certified retail territory must be the last to suffer the curtailment or

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[38] T.E. at 124-125.

interruption.[39] PJM requires pro rata interruption or curtailment of both native load customers and wholesale customers, both in-state and out-of-state, purchasing firm transmission service.[40] Thus, even if the myriad problems with the transfer discussed previously in this order did not exist, we could not issue an approval in this case. The General Assembly of Kentucky has decided that jurisdictional utilities must give native load customers the highest priority in the event of a transmission emergency. We have no authority to rule otherwise.

To summarize, there are substantial, quantifiable costs to Kentucky Power from PJM membership while there is no quantification of benefits to Kentucky Power. Furthermore, PJM's transmission priorities clearly conflict with those mandated by Kentucky law. Consequently, we find that Kentucky Power's request to transfer functional control of its transmission assets to PJM is not in the public interest and should be denied.

IT IS THEREFORE ORDERED that Kentucky Power's request to transfer functional control of its transmission facilities to PJM, pursuant to KRS 278.218, is denied.

[39] Kentucky's assertion of authority on this issue is consistent with *Northern States Power Co. v. FERC*, 176 F.3d 1090 (8th Cir. 1999), *cert. denied sub nom, Enron Power Marketing, Inc. v. Northern States Power Co.*, 528 U.S. 1182 (2000) (explicitly finding that states have jurisdiction over transmission curtailment, as it affects reliability of service).

[40] T.E. at 71-72.

Done at Frankfort, Kentucky, this 17th day of July, 2003.

By the Commission

ATTEST:

Executive Director

Case No. 2002-00475

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 2002-00475 DATED JULY 17, 2003.

Updated and Filed March 12, 2003

Data Obtained From Platt's POWERdata Database

AEP-East Companies	Production Costs $/MWh (a) 1998	1999	2000	2001
Appalachian Power Co.	17.28	16.73	15.62	17.56
Columbus Southern Power Co.	17.66	18.35	17.46	18.96
Indiana Michigan Power Co.	37.48	41.80	42.07	20.83
Kentucky Power Co.	13.24	12.61	13.73	12.45
Ohio Power Co.	19.84	19.59	21.45	20.59

PJM Companies	Production Costs $/MWh (a) 1998	1999	2000	2001
Allegheny Energy Supply Company	-	14.85	13.17	16.41
Atlantic City Electric Co.	29.53	28.16	30.70	57.38
Baltimore Gas & Electric Co.	18.79	18.93	19.57	- (b)
Constellation Power Source, Inc.	-	-	-	16.06
Delmarva Power & Light Co.	26.71	27.48	30.96	33.12
Jersey Central Power & Light Co.	27.34	24.67	34.23	- (c)
Metropolitan Edison Co.	20.22	20.39	-	- (d)
Pennsylvania Electric Co.	16.19	16.84	-	- (d)
Reliant Resources Inc.	-	-	20.73	21.98
PECO Energy Company	20.38	20.47	19.28	- (e)
Exelon Generation Co., LLC.	-	-	-	16.33
Potomac Electric Power Company	21.65	21.36	23.41	- (f)
PPL Electric Utilities Corporation	19.15	19.34	19.78	-
PPL Generation LLC.	-	-	-	16.36
Public Service Electric and Gas Company	25.72	25.24	23.22	-
PSEG LLC. (Fossil, Nuclear)	-	-	-	20.65

Notes: (a) Production Cost ($/MWh) is calculated by dividing total production cost by generation.
(b) Baltimore Gas and Electric Co.'s generating units became part of Constellation Power Source, Inc.
(c) Jersey Central Power & Light acquired by FirstEnergy Corp.
(d) Most of Metropolitian Edison Co. and Pennsylvania Electric Co.s' generating units were sold to Reliant Resources, Inc.
(e) PECo Energy Co. generating units became part of its unregulated affiliate, Exelon Generation Co.
(f) Potomac Electric Power Co.'s generating units were sold to Mirant Corp.in late 2000.